

ECONOMIC PLANNING—A SELF-DESTRUCTIVE MECHANISM?*

THERE are two possible results of the present world crisis, neither of which is peace as we knew it between the first two world wars of this century: (1) the Korean War will be isolated and will not spread; or (2) there will be a third world war. If the Korean War does not spread, there is little hope that we can live in peace—that we can be free from fear. We must assume that we shall be continuously subject to sporadic outbursts of Communist aggression in the furtherance of Russia's imperialistic designs, which clearly have world domination as their goal. We must be prepared at any and all times to meet and stop Communist aggression where it may occur. Even if there is a general war, an occurrence which events of the last two weeks have shown to be, if not probable, at least possible, there is every reason to believe that the struggle will drag on for decades. In either event, we cannot hope for more than life in a "garrison economy" for generations to come—a situation without precedent in the history of this country.

A protracted armament program means greatly increased demand by government for the product of our economy, which is already operating at full capacity to supply civilian needs. Without economic controls, the competition for scarce resources between government and civilians can only mean upward-spiraling prices. Since this competition will continue for the foreseeable future, inflation will be a permanent threat to the economy. The institution of economic controls designed to counteract this persistent tendency toward inflation

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is imminent. Since controls of a permanent danger may well become permanent themselves, it is doubly necessary that we examine the dangers to freedom inherent in such controls. Economic planning, of course, is not a new phenomenon. Since the 1930's, there has been great pressure for control of our free enterprise system especially for the prevention of depressions.

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Eighteenth and nineteenth century liberalism stressed the benefits of free private enterprise and the deleterious effects of governmental controls. These concepts were embodied in various *laissez faire* theories which assumed a harmony between private interests and the general welfare. In the United States these theories were reflected in a Constitution which provided for limited government, federalism, and a system of checks and balances. It was to be the limited role of the federal government to provide for the national defense, to protect property, to insure the sanctity of contracts, to assure free commerce between the states, and to maintain a national monetary system. Government was thereby divested of responsibility for economic organization and the individual was left free to satisfy his material needs without interference from the state.

The complex nature of productive processes and the obvious advantages of the division of labor led to the development of a system of private business which was in reality a system of *private government* that voluntarily assumed responsibility for and control of the system of economic organization. This system may be designated as capitalism, free enterprise, or *laissez faire*.

The fundamental institutional features of capitalism are as follows:¹

1. Private ownership and control of the means of production.
2. A free working class divorced from the ownership of the instruments of production.
3. The use of a wage system whereby free workers sell their services in return for a money wage based on productive effort, rather than upon some ethical concept such as need.
4. The use of a credit and monetary system.
5. A commercial agriculture to provide for the needs of an urban population which is not self-sufficient.
6. A stable government to protect property rights and to facilitate the workings of the system.

The successful operation of any system requires decisions with respect to the allocation of resources to competing uses. Furthermore, there must be a method of coördination and incentives for initiative and the assumption of responsibility. In a capitalist or free enterprise system, these requirements are met by:²

1. Maximum dependence upon competition and free play of prices to determine who shall produce what.
2. Maximum dependence upon profit rather than compulsion as an incentive.
3. Maximum emphasis on free personal choice among economic opportunities.

Historically, there have been certain restrictions imposed upon free enterprise in response to social pressures. As a result, it is not and has never been a system of complete *laissez faire*. Today it is widely accepted that:

1. Free enterprise is not the freedom to make profit by any and all means.
2. Free enterprise is not the freedom to profit at the expense of the public welfare.

3. Free enterprise is not the freedom to exploit other men.
4. Free enterprise is not the freedom to monopolize.
5. Free enterprise is not the freedom to waste natural resources.
6. Free enterprise is not opposition to necessary and appropriate government regulation or operation—often for no other reason than that it is governmental.
7. Free enterprise is not the appeal to government for subsidy or protection when adversity appears.

There are other possible forms of economic and social organization which preceded and/or have been contemporary with capitalism. For purposes of the subsequent analysis, it is necessary to consider briefly the major alternative systems: socialism, communism, and fascism. The economic characteristic distinguishing socialism and communism from capitalism is that the means of production are owned collectively rather than privately. Under fascism, while the means of production may be privately owned, their use is directed by the state for its own purposes; however, the state is generally considered to be controlled by or conscious of the interests of "Big Business." The basic difference between communism and socialism is not economic but a matter of political technique.

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It is well to recognize at the beginning of our analysis that the study of economic processes cannot be isolated from other social phenomena. Indeed, it may be said that there is but one great Science of Sociology (or political economy as some would call it) in which the economist must join with the historian, the psychologist, the philosopher, the legal theorist, the anthropologist, and others in the search for social laws. The departmentalization of our knowledge and efforts may

partially account for our ineptness in the analysis of social problems. Nevertheless, specialization is necessary because of the magnitude of social problems. It is only natural that I should emphasize the economic aspects of our subject and rely most heavily upon the technical methods of economics in the subsequent analysis.

Economics, broadly defined, is an "inquiry into the nature and causes of the wealth (and poverty) of nations." Wealth consists of all material products which were not furnished by nature in unlimited abundance but which are necessary, useful, and agreeable to man.³ The creation of wealth is restricted by the physical limits of a nation's resources, both natural and human, and the rate at which they may be exploited in accordance with given technological knowledge.

When a nation is exploiting its resources at the optimum physical and technological rate, it is said to be at "full employment." When a society's economic system fails to reach full employment, it exposes some members of that society to physical want and suffering. It exposes the society itself to pressures from these members—pressures for political and economic change. If an economy cannot supply work for all members of the society, when work is necessary to obtain the monetary means whereby goods and services necessary for life can be bought, then it is not unreasonable to expect political pressure from those who are forced to do without. Such pressure is directed toward a change *in* the system, or *of* the system, in order to increase the national product and to provide these dispossessed groups or individuals with what they consider to be their rightful share.

If we measure a society's economic effort in terms of the monetary value of its production within a given period, then the national product or national income consists of private household expenditures on consumption goods, plus private

business expenditures on producers goods, plus government expenditures for the products of private firms or for labor which is used to produce government services. The level of employment of resources is determined by the sum of the expenditures by these three sectors of the economy.

Free enterprise systems have characteristically been subject to recurrent periods of depression or deflation. In such periods the total expenditures by the sectors fall short of the level necessary to support full employment. Furthermore, capitalist economies have occasionally faced temporary inflationary periods in which the sum of the expenditures of the three sectors rises above the full employment level with resultant price spirals. Alternating periods of prosperity and depression are generally accepted as inescapable characteristics of so-called unplanned free enterprise systems.

In addition to the grave dangers posed by inflationary and deflationary conditions, it has been asserted that our capitalist economy was threatened in the 1930's by a new peril. This was the threat of permanent equilibrium at less than full employment. Many believed that "secular stagnation" had set in, that the economy had become permanently unable fully to employ its labor force.

These then are the origins of the political pressures for changes *in* or *of* our capitalistic system.

Some advocated the substitution of other economic systems on the grounds that (1) free enterprise could never achieve and maintain full employment of resources, or (2) that even if full employment could be achieved, free enterprise would be a less efficient form of industrial organization than the particular system which they advocated.

Others contended that free enterprise should accept such control devices, such "planning," as might be necessary to meet the goal of full employment. These were persons who

defended free enterprise as the best form of economic organization in spite of its admitted inability to maintain full employment at all times, and in spite of the possibility that it might never again achieve full employment. Some would claim that this group also included those who advocated other systems, but believed that a gradual modification of free enterprise was an easier way (politically and economically) to attain these systems than to seek immediate, total socialization of the economy.

But the pressure for the introduction of controls for the purpose of saving free enterprise met opposition, largely from those who appear to be the most vigorous supporters of this particular type of economic system. Why? First, they may have believed that *any* control by definition eliminates the free enterprise system, that "free enterprise" and "control" are mutually incompatible terms. A corollary of this belief is that such widespread suffering as that which occurred in the 1930's was unusual and would not recur. Depressions might again occur but would not be so severe as to create danger of political upheaval. In any event, control would mean the end of free enterprise and there was nothing to lose by hoping that future economic dislocations would not be fatal.

Second, they may have believed that abandoning the free enterprise system *in toto* would mean the eventual loss of something more important than economic freedom, namely, personal freedom. If personal freedom depends upon the existence of the free enterprise system, then the loss of that system entails the loss of something for which there is no recompense, not even the elimination of recurrent periods of material want.

The combination of these two views is the most restrictive. If one believes that any economic control means the end of free enterprise and that the end of free enterprise means the

end of personal liberty, then there could indeed be no choice between the possible loss of personal liberty from failure to institute so-called "corrective controls" and the certain loss of personal liberty from the *institution* of such controls.

This was the great economic dilemma of our time. If we did not control the free enterprise economy, we subjected ourselves to recurrent periods of economic depression and the risk of political subversion of our society. If we attempted to control, we risked the loss of the free enterprise system, since it may be that any control is incompatible with free enterprise. Further we risked the loss of personal political freedom, since this may depend on the existence of economic freedom. Controls designed to avoid serfdom might eventually lead to serfdom.

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Until five months ago, this dilemma was nurtured by the specter of recurrent or persistent unemployment. Since the outbreak of the Korean War, a new and potentially more serious danger faces us. Today, and for the foreseeable future, depressions are of remote concern. The specter today is that of perpetual, persistent, cumulative inflation.

Economically, the danger arises from the fact that a society experiencing galloping inflation has great difficulty in distributing its product. In depressions, we do not produce *enough* for all. In inflations, equal economic hardship for many groups or individuals can arise from their inability to obtain a sufficient *share* in the national product, which may be at a physical maximum. Even though the economy produces at the maximum physical rate, those groups whose incomes lag behind the rise of prices in inflationary spirals suffer hardships. Their attempts to correct this situation by demanding higher wages and salaries only serve to intensify the inflation, causing new demands for higher pay. One thinks

of a dog chasing his tail, where the head is marked prices and the tail wages, or vice versa.

The political pressures resulting from the rising cost of living in 1947-1948 are well known to all of us. What is the political potential of such pressures if the cost of living should continue to rise for the foreseeable future at an ever increasing rate? If anyone doubts the force of political unrest that is carried in galloping inflations, let him look back only as far as Austria and Germany in the early 1920's.

Today, inflation is even more dangerous to our society than it would be in time of true peace. Why? The basic cause of this inflation is rearmament. Military and civilian needs compete for the products of an economy operating at full capacity. There is a high degree of unanimity that rearmament is necessary if we are to preserve any peace and save the Western world from Russian imperialism. But when depressions were the threat there was a widespread opposition to the introduction of controls.

The key to the former problem of maintaining full employment was governmental fiscal policy. By this we mean the attempt of the federal government to maintain high levels of national income approaching full employment by the use of certain devices of fiscal and monetary policy which operate on the national income aggregatively. Such devices are variations in tax yields and government expenditures over time. Tax yields are increased as national income rises toward full employment in order to avoid inflation. Conversely, they are decreased as national income declines in times of depression, to provide additional funds for consumers and businessmen with which they may buy and invest in order to offset any tendencies toward such catastrophes as the depression of the 1930's. The most direct evidence of such policies is a theoretical government budgetary deficit

in times of depressions and a government budgetary surplus in times of booms. In addition, there are certain powers over the availability of credit which are exercised by the Federal Reserve System, e.g., making interest rates lower in depressions to encourage borrowing and higher in booms to discourage inflationary investments, restricting consumer and stock and commodity market credits in booms, etc.

To a certain extent, fiscal policy measures operate automatically in the desired direction as national income rises or falls. When incomes rise sharply, income tax yields automatically rise, even though the tax rate is fixed, and siphon off inflationary purchasing power. When incomes fall in depressions, income tax yields fall, leaving a larger proportion of received income for consumers and businessmen to spend. Similarly, the amount of money disbursed for government unemployment insurance rises in depressions when consumer purchasing power is low and falls in booms when consumers are employed.

There is a debate between economists as to whether this "built-in flexibility" is enough to preserve full employment and prevent inflation. Many would argue that it is not, contending that in galloping inflation, tax rates should be raised. In deep depression, they should be cut sharply; public works should be instituted in order to feed purchasing power into the hands of consumers and cause businessmen to invest in inventories and employ workers in order to fill government contracts for these public works. In short, *discretionary* measures would be necessary to avoid galloping inflation or crashing depressions.

It will be noted that the essential characteristic of all these measures of control over the economy of which we have spoken in regard to the pre-Korean situation are *aggregative* controls. This is opposed to what we may call *particular* con-

trols, i.e., regulation of individual businesses directly by the government. Nearly all economists agree as to the advisability of built-in fiscal policy measures. It is probably safe to say that most economists believe that some discretionary action is inevitable in extraordinary periods of decline or rise of national income, e.g., 1930 and 1948. But few American economists believe in the minute control of all businesses by government. Those who do are planners for the sake of planning. At the very least they are close to being Socialists. We have of course had some of what we might call permanent, direct regulation of enterprise in this country. The Sherman Act, the Robinson-Patman Act—these limit the actions of businessmen severely. Even more direct regulation is that which we have long ago accepted—the regulation of certain industries which we call “public utilities” because of the essentially public nature of their services.

In recent years the President's Council of Economic Advisers has gone even further in asking Congress to grant the federal government power to create additional capacity in such industries as steel, where government planners do not feel that there is enough capacity for the natural growth of the economy.

The direct controls which may be necessary to fight persistent inflation, however, are far more stringent than mere anti-monopoly legislation. In times of national emergency with full employment of resources, it is necessary to allocate the limited output of certain goods for which both civilians and the military compete. Such allocation requires direct interference in the conduct of individual enterprises, not merely general controls over the whole economy under which businessmen are left relatively free to make decisions. Recall the economic controls of the second World War. Now the government again has the power to institute price controls, quan-

tity (i.e., priority) controls, credit controls, and rationing. When government regulates prices which the individual businessman may charge, when it limits the quantities of certain materials he may buy and the quantity he may sell, indeed, when it tells him how much to produce—then government has taken from the businessman much or all of his power to make economic decisions. When it does, capitalism as a method of economic organization is seriously menaced. In the last war controls were temporary and private capitalism was reinstated afterward. Today the threat is *persistent* inflation. The controls may be permanent. There may be no “after” period.

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What is the effect of the introduction of controls in a free enterprise economy? There are three lines of opinion expressed in the economic literature. These are exemplified by the works of Karl Marx,⁴ Joseph Schumpeter (late Professor of Economics at Harvard University),⁵ and Friedrich Hayek (Professor of Economics, London School of Economics).⁶

Marx of course was actually not concerned with the effects of economic controls *per se*, but his familiar economic determinism would deny that such controls drive us along the road to socialism. Such a process is inevitable. Indeed, a literal application of his economic interpretation of history would indicate that both the Hayek school and those who say that free enterprise can be saved by some control are wrong. The process of accumulation of capital by the aggressive capitalist leads to a polarization of society into bourgeois and proletariat, into “haves” and “have-nots.” Such a polarization is inevitable. As time passes, more and more people will fall into the “have-not” group from the “semi-have” group, i.e., the middle class. This class will cease to exist. The haves will continue to have progressively more. The have-nots will

continue to have progressively less. In the end, privation will drive the far more numerous have-nots to rise up and overthrow the haves by violent means. Capitalism has inevitably sown the seeds of its own destruction.

But history has shown that, at least to date, Marx has been wrong. His great error has been in not anticipating the fact that both haves and have-nots could increase their standard of living. This has been possible for two reasons: (1) the capitalist, free enterprise economy has been so successful in its recurrent boom years in the creation of wealth, that there has been sufficient wealth to permit rapid and substantial increases in mass standards of living; (2) Marx failed to give the defenders of capitalism credit for second sight. He committed an error fatal to so many military operations, for indeed world revolution might be called that. He underestimated the enemy. We may use an analogy from the economic theory of competition among the few. The rational entrepreneur who operates in a market where he faces only a few competitors must engage in what we call "conjectural variation." When planning a price cut, an advertising campaign, etc., he must first consider what his competitors think he thinks they think he is going to do.

Marx failed to consider that the defenders of free enterprise would consider the effects of his theories upon the proletariat, and the possible reactions of the capitalists. Indeed, a cynic might say that Marx ruined his own cause. Perhaps the capitalists would not have recognized the danger. The furor caused by *Das Kapital* and the *Communist Manifesto* was sufficient to arouse at least a few. Hence, the capitalist-defending politician institutes such things as social legislation and fiscal policy to help free the proletariat from want. Economic determinism is defeated by conscious measures designed to remove the potential causes of social upheaval.

Professor Schumpeter would say that while "Marx was wrong in his diagnosis of the manner in which capitalist society would break down; he was not wrong in the prediction that it would break down eventually."⁷

According to Schumpeter, the capitalist order tends to destroy itself for four basic reasons which may be summarized as follows:

(1) The very success of the capitalist class in developing the productive powers of this country has somewhat obviated the necessity for its existence, making its replacement by a bureaucracy easier. Economic progress tends to become depersonalized and automatized. The very fact that this success has created a new standard of life for all classes has undermined the social position of the business class.

(2) The capitalist system is based on the maximization by every individual of "his own (short run) utilitarian ends." Where this is true, there is a tendency to the destruction of loyalties of subordinates toward the leaders of production. These loyalties are necessary for the maintenance of efficient leadership and a leading capitalist class.

(3) The capitalist system, while it has created prosperity which has overflowed to the petty bourgeoisie, has at the same time antagonized these groups by its successful achievement of bigness. These groups have prospered under the umbrella of capitalist development, but this prosperity has permitted the growth of a class which does not have the interests of large-scale business at heart and constitutes a potential opposition to capitalism. Similarly, an intellectual opposition has prospered. The very increase of the standard of living which capitalism has engendered enables these opposition classes more effectively to oppose.

(4) The scheme of values of a capitalist society, principally private profit and individual property rights, decreases in importance as capitalism succeeds in creating ever larger, legalistic, impersonal business units. The stockholder of the American Telephone and Telegraph Company feels little driving, personal interest in the conduct of "his" enterprise; indeed, he has no effective say in its conduct. Security and equality—these are more and more becoming the dominant economic motives.

Schumpeter emphasizes the distance we have traveled from *laissez faire* capitalism. He is of those who would call any control a departure from free enterprise: fiscal policy to prevent depression; anti-monopoly regulation; labor market regulation; money market regulation; extension of the range of wants satisfied by governmental effort. All these are common today and widely accepted. By definition they are departures from free enterprise. As they are extended, the departure from free enterprise will be accentuated.

Schumpeter has always stressed that he speaks of long-run tendencies. He admits, however, that while mere events (such as total wars!) cannot change these deterministic tendencies, they can create situations which let them accelerate. An example of such a situation is inflation. Such controls as are necessary to meet the threat of persistent inflation can only speed us along the predetermined road from *laissez faire* to socialism. It is possible that the evolution might stop somewhere short of complete socialism, perhaps with freedom of economic activity still remaining to farmers, retailers, and small producers—but this is not capitalism.

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Marx and Schumpeter would have us believe that capitalism contains the seeds of its own destruction, that the more efficiently it operates, the more efficiently and surely it will destroy itself.

Professor Hayek, a defender of the capitalist economic system, disputes this position violently. He cannot accept the economic determinism of Marx and Schumpeter. We are not inevitably led anywhere that we do not *want* to go. If we restrict free enterprise, then we doom ourselves to serfdom. But there is no reason why we cannot by appropriate political action reverse the trend toward socialism and return

to free enterprise in those countries where it has been left behind. It is not the capitalist system *per se* which will destroy us, but the economic planning which interferes with its operation. Further, according to Professor Hayek it is not even planning as such that we must fear, but the wrong kind of planning. He asserts that the term "planning" has unfortunately acquired unpleasant overtones. Economic planning by someone is necessary in any system, be it capitalist, socialist, or communist. It is a question of who does the planning. In a free enterprise economy it is individual businessmen who plan. In a socialist economy, the planning is done by one central authority. What we have to fear is the usurpation of decision-making by central government. Further, some planning by central government is permissible, and even necessary, for the free enterprise system to work. This kind of planning must be planning *for* competition, not planning *against* it. The former will help us maintain and improve the workings of the free enterprise system. The latter will lead us to serfdom. Centralized planning which is not *for* competition is only permissible, in general, where competition cannot be made effective by the proper legal framework.

In other words, necessary planning is all right. Unnecessary planning is not. The skeptic immediately must ask: "Where do we draw the line?" To a large extent, Professor Hayek dodges this problem. There is little doubt that the type of planning we face in a war economy, namely, direct control of prices, raw materials, etc., is of the "unnecessary" type. But what of aggregative income control, the device we have used in the past to assure full employment? Professor Hayek seems to ignore this point—as do other British writers. To them it is socialism *in toto* which is the danger—not merely fiscal policy.

Professor Hayek does commit himself on these points:

(1) Government must not attempt price or quantity regulation—here the “system is no longer free and does not provide a guide to business actions.”

(2) Prescribing conditions of production for *all* producers is permissible. (This might mean that regulation of the level of income would be permissible, since all producers would be equally affected with a minimum of interference with private decision making.)

(3) Social services that do not render competition ineffective over wide fields are permissible.

(4) Government may provide a monetary system, market regulation, and business information.

(5) Government may set up a legal structure sufficient to let competition work.

If planning exceeds these limits of “for competition,” then competition ceases to operate as an effective guide to production. A mixture of competition and controls “means that neither will really work and the result will be worse than if either system had been consistently relied upon.” Why? For competition to work, we must have a free price system. When we do, we have the best economic system. When we do not, competition is ineffective. Similarly, half-hearted planning is worthless. Once we abandon competition for semi-planning, we must go all the way to achieve an efficient allocation of resources and production of wealth. Once we limit competition, we must surrender our economic liberty to achieve an efficient production of wealth.

Before proceeding further with Professor Hayek’s thesis, it is necessary to pause and examine its economic implications.

The capitalism of Schumpeter is characterized by innovating capitalists, e.g., Andrew Carnegie, whose goal is the accumulation of large quantities of capital and the making of profits. Indeed, success of the capitalist system is shown in such giant enterprises as the Carnegie steel works. But Hayek

has a different concept of free enterprise or capitalism. Remember that Schumpeter specifically listed anti-monopoly regulation as a departure from free enterprise. But under Hayek's system such legislation would be a mandatory part of that planning necessary to make competition work. To Professor Hayek *competition* is the essence of a free enterprise system. Competition is the best economic system for two reasons: (1) it is the most efficient method of controlling economic activities; (2) it is the only one not requiring coercive or arbitrary authority. But this latter reason is obviously inconsistent, since he himself admits the necessity for setting up a legal framework in which competition can work. Enforcement of laws requires coercion. Anti-monopoly regulation is an example. He admits that monopoly exists; consequently action must be taken against it for competition to work. Bigness in business becomes an evil equal almost to socialism. Bigness, indeed, is the evil he attacks, be it private bigness or public bigness.

As for the first reason: Why is competition the most efficient way of controlling economic activities? Because the price system working freely supplies the information which permits each individual businessman to make his decisions on how much labor and capital to employ for what output. Decisions must be made on the individual firm basis for the simple reason that the complexities of economic life have become so great as to defy economy-wide regulation of the industrial system. No board or agency can possibly have the necessary information or brainpower to cope with the many variables which must be considered when, say, changing a price. The central pillar on which his claim for competition stands is a freely working price mechanism.

In Hayek's words:

"Because all the details of the changes constantly affecting the conditions of demand and supply of the different commodities can never be fully known, or quickly enough be collected and disseminated, by any one center, what is required is some apparatus of registration which automatically records all the relevant effects of individual actions and whose indications are at the same time the resultant of, and the guide for, all the individual decisions. This is precisely what the price system does under competition and which no other system even promises to accomplish. It enables entrepreneurs, by watching the movement of comparatively few prices . . . to adjust their activities to those of their fellows. The important point here is that the price system will fulfil this function only if competition prevails, that is, if the individual producer has to adapt himself to price changes and cannot control them."⁸

To how many producers in our present-day economy does this apply? How many producers cannot influence the price of their products? Pure competition in this theoretical sense necessitates the following condition: every producer must have an output so small in relation to the total market for his product that if his production were completely eliminated there would be no price change. I submit that there are practically no industries in the American economy today where this is true, outside of agriculture. If all production of Fords stopped, what would happen to automobile prices? Cannot the Ford Motor Company vary its own car prices? The economic system Hayek envisages is one from a dream world that has not existed in this country since we began to evolve from an agricultural into an industrial nation. To attain it, to make this kind of competition work as the best economic system, would necessitate a complete revamping of our economic system, would necessitate an application of arbitrary authority by the side of which socialism would be indeed a mild form of revolution. Literally interpreted, his thesis calls for the dismemberment of every producing business which is large enough to be able to influence the

price of its product, which means practically every business. In the first place, this is impossible. In the second, it would sacrifice all of those economies which we have obtained from large-scale mass production—one of the things which has created the high mass standards of living in capitalist nations.

There remains to be considered the rest of Professor Hayek's thesis. If we lose our economic freedom, then Hayek claims that we shall inevitably lose our political freedom. The former is a prerequisite to the latter. "Democratic Socialism" is impossible. Hayek stresses the fact that Fascism in Italy grew out of a socialist movement. He stresses that socialism as practiced in Russia has brought totalitarianism at least as absolute as that practiced in Germany and Italy in the 1930's. To point up the value of a competitive system, he stresses the far *rightist* roots of Nazism. Socialism and big business are after all the same thing with different owners: government and monopolists, respectively. They are almost equally evil and dangerous to mass freedoms. Any socialist system must inevitably become a totalitarian system. Those having economic power become power-mad and usurp political power and political freedom. "Socialism" denies the possibility of "individualism" by definition.

Freedom he defines as "freedom from coercion, freedom from the arbitrary power of other men, release from the ties which left the individual no choice but obedience to the orders of a superior to whom he was attached." A nationalized state obviously removes these liberties in so far as many economic decisions are concerned. Hayek cannot conceive of their loss only in part, *viz.*, the economic part; this partial loss must necessarily be followed by their total loss.

A basic inconsistency in Hayek's arguments should now be clear: any arbitrary government direction of business leads

to the loss of political liberty. But to attain the economic system he desires would necessitate long and bitterly arbitrary government action. It is not immediately clear why those who seize private property to nationalize it should be any more likely to become power-mad and usurp political freedom than those who seize private property to redistribute it to other private owners by breaking up large-scale industry.

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Perhaps the easiest way to remove the questions raised by these three economists is to analyze the reasons behind them. It is not difficult to rationalize away their views.

Marx's goal was world revolution; consequently he could point out to the proletariat that such would come eventually; so why endure further privation? "Workers of the world, unite!"

Professor Schumpeter's doctoral thesis is the first major economic work to stress the vital economic role played by the industrial capitalist of the late nineteenth century. The capitalist's is not the destructive role assigned him by the great critic of the robber baron age, Veblen; he is not an agent of destruction. The role of the entrepreneur is that of the promoter of progress through innovation. His motives for innovating are the capitalist values we have referred to. True, those whose products or processes he makes obsolete are destroyed. But this, as Schumpeter calls it, is the process of "creative destruction." Some must fall by the wayside if we are to have progress. Schumpeter was never so overwhelmed with the horror of depression as were many other economists. To him depressions were a cost of progress. Economies progressed in bursts arising from some important innovation which caused imitation and began a boom. The following depression was the sign of necessary retrenchment

as those whose products became outmoded were crushed in the process of creative destruction. Depressions were a terrible but essential accompaniment of progress. Any attempt to control them might wipe out progress. True, more were harmed than necessary because of the cumulative nature of depression. But eliminating them completely might well have eliminated progress.

To Schumpeter any departure from the era of the innovating capitalist is a departure from the very essence of capitalism. Capitalism with restricted entrepreneurs or new motivations, such as the "laborist capitalism" of the New Deal, is not capitalism. Capitalism is dying a slow death.

Professor Hayek is a good Tory. His detractors immediately pronounced his book an effort to assure that England would not vote Socialist in 1945. He appealed to those who stood to lose economically, true. But *they* did not need to be appealed to. He appealed to all Englishmen by threatening them with something they would never voluntarily surrender, no matter what the economic gain, *viz.*, the loss of their political freedom. His was a great political tract (he is one of the few prominent economists ever to write a book which became a best-seller). A less cynical critic might with some justice point out that Professor Hayek is of that school of economists which believes fervently that pure competition between small firms is economically the most efficient form of industrial organization. His book is an eloquent appeal (1) for the establishment of planning which will guarantee that such an economy can operate, and (2) for an end to any planning which will interfere with pure competition.

How much simpler it would be to accept these as rationalizations. If we believe that capitalism is the best economic system, as I do, why not say with the late Henry Simons that

"some of us dislike government by authorities partly because we think they would not be wise and good and partly because we would still dislike it if they were."⁹

But we cannot afford to pass over the work of these men as the rationalizations of their basic intellectual beliefs, as attempts to support those beliefs. For it is not inconceivable that they are right, at least in part.

Do attempts to maintain free enterprise lead to serfdom? Is planning self-destructive? Or, indeed, is capitalism *itself* a self-destructive mechanism, as Marx and Schumpeter would have us believe?

We may agree with Marx that capitalism is doomed. But the causes of the destruction and the process of disintegration have certainly been contrary to the views of Marx. There is no current evidence that the standard of living of the working classes will begin a sharp decline while mass accumulation of wealth by the capitalist class begins a sharp ascent. Labor unions having the power to maintain wages, a prospering middle class, progressive income taxes which discourage large personal accumulations of capital—all such institutions characteristic of our economy today will serve to prevent the predicted polarization of society.

Schumpeter's analysis is a more accurate contemporary description of the disintegration which has already occurred. The very success of the capitalist class in creating a highly efficient productive mechanism has made management more routine and more amenable to bureaucratization. Capitalist values of profit and private property are less important today for many people who are interested in security rather than profit-seeking enterprise.

Capitalism of today may well be called what Schumpeter describes as "laborist" capitalism. The laboring class, recog-

nizing that the capitalist class is willing to make concessions to the proletariat to avoid violent revolution, takes advantage of this situation and uses democratic processes and majorities to achieve further concessions. This process may well lead to a system in which collectivist planning and control is carried on within a capitalist form of economic organization, i.e., private ownership. We shall then have achieved a form of capitalism not materially different from pure socialism. "Laborist" capitalism is a movable "half-way house" between capitalism and socialism.

Although we may agree with Schumpeter about the extent to which we have already moved toward a socialist system, we cannot accept pure socialism as inevitable. We agree with Hayek that we need go only where we want to go. Even Schumpeter admits that we may not go all the way. The "half-way house" may survive indefinitely.

But our agreeing with Hayek that we can stop the movement to socialism and turn back to free enterprise if we wish, does not mean that we agree with him that there can be no "half-way house," that once we accept *some* socialism, we must accept total socialization. If we can stop and go back, can we not stop without going back? Or can we not redirect the evolution of economic society in some other direction than socialism if we can check this evolution at all? Hayek's whole argument for going back to his theoretical competition rests upon these claims: (1) that competition is the most efficient economic system; (2) that semi-planned, semi-competitive systems will not work. We have earlier shown that a competitive system such as he desires is impossible of achievement without a complete reorganization of our industrial structure. Our present industrial system *is* achieving full employment of resources. But this is not Hayek's system. It is a partly-planned system. Its existence refutes his con-

tention that partly-planned systems cannot fulfill the economic goal. Capitalism is potentially self-destructive. But we reject the inevitability of this destruction. We reject absolute economic determinism. The forces of destruction may be halted and changed by conscious action. They need be changed in no specific direction. We can destroy our economic and political institutions by controls; planning can be self-destructive. The institution of controls—even those designed to save capitalism—may actually promote the destructive process. But it is certainly necessary to avoid blanket indictment of all controls. Broad policies and controls which establish general rules of business conduct may be necessary and beneficial provided we avoid specific direction and interference with individual choice and decision. More specifically, control of the business cycle may be achieved by intelligent management of federal fiscal policy—taxes, debt, and the budget. We have seen that it is even possible that Hayek would accept the necessity of these controls.

However, broad, indirect controls designed to offset temporary conditions of deflation or inflation may be extremely dangerous if used as weapons against persistent, cumulative inflation and may aggravate the trend away from *laissez faire* capitalism. For example, corporate and personal income taxes are useful weapons against short-run inflation but may well cause long-run stagnation. If such taxes are levied to an extent which discourages investment and expansion by the groups which perform these essential capitalist functions, then a growing population will soon outstrip the economic capacity of its society. Permanent inflation is not avoided and capitalism is weakened.

Direct price and priority controls are clearly a “surrender of private enterprise to public authority” and constitute a major move toward a centrally planned economy. Further,

they give a bureaucracy an opportunity to grow and become skillful in economic control—skillful and ambitious enough to increase its pressure for the permanent transfer of control to itself.

For some time after the beginning of the Korean War, it appeared that we might possibly avoid such controls in a semi-war economy. We knew that our basic economic need was more capacity—that this was the only effective weapon against persistent inflation. With more, say, steel capacity, we could have both guns *and* washing machines, not guns *or* washing machines. It was clear that if private enterprise failed to recognize this need or was unwilling to use its own funds and assume the risk of such expansion, then the structure of free enterprise would be further weakened—for government would carry out the expansion. We recognized that increased taxes and direct controls over wages, prices, and materials might be necessary as short-run weapons, but they should be administered in such a way as to encourage expansion by private business if government wished to assist in the preservation of capitalism.

But the intervention of Red China and an accelerated rate of rearmament makes it less likely that we can avoid direct controls. Higher taxes and governmental control of credit and materials are already upon us. Direct controls over manpower, prices, and wages are not far off. Such controls can be tolerated and are unquestionably necessary during limited periods of national emergency.

It is an entirely different matter if we must embrace such controls for a protracted period. What kind of a half-way house would we be living in? The economic theory of socialism provides a useful suggestion: the so-called competitive solution to the organization of a socialist society. Professors Abba P. Lerner¹⁰ and Oscar Lange¹¹ have attempted to show

that it is possible for a socialist system to have free consumer choice and decentralized decision making. Productive decisions would be made by the managers of individual firms, just as they are in a capitalist system. Such firms would be allowed to make profits, just as in a capitalist system. There would be a central planning board (similar to the present National Security Resources Board), but this board's function would be only generally to supervise reallocation of materials to those businesses which are shown to need them by increases in the prices of their products. Such price increases would mean that consumer choice dictates this reallocation of resources. The business units would be publicly owned; yet the managers, in theory at least, would be practically independent.

The "competitive solution" is, in my opinion, more applicable and likely (in a modified form) in the garrison economy which lies ahead than it would be under true socialism. Most true socialists want to plan centrally for the purpose of coördinating the various sectors of the economy in accordance with some predetermined concept of social welfare. However, the "competitive solution" could be built into a framework of private ownership and could exist in a garrison economy for a considerable period of time if we want or need such a system. Some central control, probably more than that contemplated in the theoretical system, would be necessary. The successful operation of this "mixed system" would depend upon a substantially free price system. Where individual business units could and did control their prices enough to interfere unduly with the allocation of resources to necessary military and private needs, direct action by the central board (e.g., allocation and rationing) might be expected.

Finally, we must consider the long-run effect of economic

planning and controls upon political freedom. Is Hayek correct in asserting that the loss of economic freedom will entail the loss of political freedom?

It must be admitted that economists have no special qualifications to define the concept of freedom as a social objective. If, however, there is a connection between economic freedom and political freedom, then we must carefully weigh the dangers and erect in our minds a barrier designed to contain their effect upon political freedom before consenting to the imposition of even necessary economic controls. We have seen that Hayek supports his argument with such evidence as the socialist antecedents of Italian Fascism. But we must not ignore other cases where democratic socialism does exist. Sweden, England, and other European countries have experienced varying degrees of socialism for varying periods of time. They still maintain a vigorous political opposition, the right to vote and unseat, religious freedom, a free press—in short, the traditional political freedoms of the Western world. The very reason for the cautiousness of present-day British Socialism as contrasted to its more ambitious programs of the 1920's and the 30's is the fear of political defeat. If democratic socialism is possible, then a democratic half-way house is clearly possible. However, lest we be too optimistic, we must not ignore the possibility that restrictions of our economic freedom—even the relatively mild restrictions of our present half-way house—may create a tolerance and a laxness in our defense of freedom.

Private ownership and decentralized planning have dispersed economic power in the hands of many independent individuals and private business units both large and small. This situation has provided the individual whether he be consumer, worker, or capitalist with an almost unlimited number of choices. The individual is continuously condi-

tioned to freedom in the economic field by being able to turn away from that which he does not like and choose an alternative. Surely this way of life has contributed to a habit of freedom. Similarly, economic regimentation may well condition us to political regimentation.

But the maintenance of political freedom in either a regimented or free economy depends upon the intensity of our *desire* for freedom. If we let economic conditioning for regimentation destroy our desire for political freedom, or if we let existence for generations under even mild regimentation be so irritating and discouraging as to create an atmosphere of defeatism which dampens our desire for freedom—then surely all is lost, and planning will have destroyed our political system.

J. E. HODGES

NOTES

1. See Louis M. Hacker, *The Triumph of American Capitalism* (New York, 1940), pp. 16-19.
2. The following discussion of the meaning of free enterprise is based on William B. Benton's "The Economics of a Free Society," *Fortune*, October, 1944, pp. 163-164. Senator Benton was then writing as Vice Chairman, Board of Trustees, the Committee for Economic Development.
3. Thomas Robert Malthus, *Definitions in Political Economy* (London, 1827), p. 11.
4. See, for example, the *Communist Manifesto* (1848).
5. J. A. Schumpeter, *Capitalism, Socialism and Democracy*, 2nd ed. (New York, 1947).
6. F. A. Hayek, *The Road to Serfdom* (Chicago, 1944).
7. J. A. Schumpeter, "The March into Socialism," *American Economic Review*, May, 1950, XL, p. 456.
8. Hayek, *op. cit.*, p. 49.
9. Henry C. Simons, "The Beveridge Program: An Unsympathetic Interpretation," *Economic Policy for a Free Society* (Chicago, 1948), p. 309.
10. A. P. Lerner, *The Economics of Control* (New York, 1944).
11. O. Lange and F. M. Taylor, *On the Economic Theory of Socialism* (Minneapolis, 1938).